

Message Text

CONFIDENTIAL

PAGE 01 STATE 076239

62

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E.O. 11652:GDS

TAGS:PFOR, NATO

SUBJECT: US PAPER FOR APRIL 14-17 NATO APAG MEETING

1. THERE FOLLOWS BELOW UNOFFICIAL US PAPER PREPARED BY
DEPARTMENT'S POLICY PLANNING STAFF AS CONTRIBUTION TO
APRIL 14-17 NATO ATLANTIC POLICY ADVISORY GROUP AT
ROYAUMONT.

CONFIDENTIAL

CONFIDENTIAL

PAGE 02 STATE 076239

2. FOR USNATO: PLEASE DISTRIBUTE COPIES OF PAPER TO KASTL AND OTHER DELEGATIONS AS YOU DEEM APPROPRIATE. PLEASE INFORM KASTL THAT BECAUSE OF SHORT TIME LEFT BEFORE MEETING WE ARE ALSO ASKING EMBASSIES IN NATO CAPITALS TO TRANSMIT COPIES TO FOREIGN OFFICES IN ORDER TO MAKE SURE PARTICIPANTS RECEIVE TEXT SUFFICIENTLY IN ADVANCE OF APRIL 14.

3. FOR CAPITALS: PLEASE PASS COPY TO APAG PARTICIPANTS IN HOST FOREIGN OFFICE.

4. REQUEST DISTRIBUTION BE MADE IN BRUSSELS AND CAPITALS ON FRIDAY, APRIL 4 IN ORDER THAT PARTICIPANTS WILL HAVE AS MUCH TIME AS POSSIBLE TO READ PAPER BEFORE APAG MEETING.

5. BEGIN TEXT:

NATO APAG MEETING APRIL 14 - 17, 1975: US DISCUSSION PAPER ON TRADE AND NATURAL RESOURCES IN THE EAST-WEST CONTEXT. (NOTE: THIS PAPER WAS PREPARED FOR DISCUSSION AND DOES NOT NECESSARILY REPRESENT THE OFFICIAL VIEWS OF THE UNITED STATES GOVERNMENT.)

I. INTRODUCTION

THE 1970'S HAVE SEEN A SUCCESSION OF BLOWS TO WORLD ECONOMIC WELL-BEING AND THE INTERNATIONAL ECONOMIC SYSTEM. THEY HAVE UNDERSCORED THE GROWING INTERDEPENDENCE AMONG NATIONAL ECONOMIES UNDERWAY SINCE WORLD WAR II.

-- HIGH LEVELS OF GLOBAL BOOM HAVE GIVEN WAY TO THE DEEPEST ECONOMIC DOWN-TURN SINCE THE 1930'S;

-- THE 1973-74 DISRUPTION IN OIL SUPPLY AND THE QUADRUPLING OF PRICES IN LESS THAN A YEAR HAVE FUELED RUN-AWAY INFLATION, HELPED PRECIPITATE RECESSION, AND BURDENED DOMESTIC AND INTERNATIONAL ECONOMIC STRUCTURES AND DECISIONS;

-- THE WORLD FOOD CRISIS, TRIGGERED BY AN UNUSUAL DECLINE IN PRODUCTION IN 1972, PRACTICALLY EXHAUSTED WORLD
CONFIDENTIAL

CONFIDENTIAL

PAGE 03 STATE 076239

FOOD RESERVES AND LEFT A THIN MARGIN OF SAFETY AGAINST FUTURE SHORTAGES;

-- THE WORLD-WIDE BOOM BROUGHT SHORTAGES AND SKY-ROCKETING PRICES FOR MANY CRITICAL COMMODITIES; THEN THE ONSET OF WORLD RECESSION CAUSED SAGGING PRICES AND SURPLUSES;

-- LESS DEVELOPED COUNTRIES HAVE MOUNTED A CAMPAIGN FOR
A RADICAL RESTRUCTURING OF INTERNATIONAL ECONOMIC AFFAIRS,
WITH NATURAL RESOURCES POLICY IN THE VANGUARD;

-- ESTABLISHED ARRANGEMENTS AND INSTITUTIONS OF THE
WORLD ECONOMIC ORDER HAVE BEEN UNDER INCREASING STRAIN, WITH
CONTINUING PRESSURE FOR REFORM AND CHANGE.

MASTERING THE PROBLEMS CAUSED BY THESE EVENTS HAS TOP
PRIORITY FOR THE NATO NATIONS. AT STAKE IS OUR ECONOMIC
WELL-BEING AND STABILITY AND ULTIMATELY THE COHESION OF OUR
SOCIETIES AND STEADINESS OF OUR POLITICS. AT ISSUE ARE OUR
POLITICAL SOLIDARITY AND COMMON SECURITY, AND OUR ABILITY TO
SHAPE A WORLD POLITICAL-ECONOMIC ORDER CONSISTENT WITH OUR
INTERESTS AND VALUES.

NEW EFFORTS ARE UNDERWAY, OR IN PROSPECT, FOR INTER-
NATIONAL COORDINATION OF NATIONAL ECONOMIC POLICIES, TRADE
AND MONETARY ARRANGEMENTS, AND NATURAL RESOURCES. IN ENERGY
AND FOOD WE HAVE CREATED NEW STRUCTURES OF INTER-NATIONAL
COOPERATION. POWERED BY POLITICAL AND ECONOMIC NECESSITY,
THESE EFFORTS COULD PROGRESSIVELY REORDER INTERNATIONAL
ARRANGEMENTS AMONG THE INDUSTRIAL DEMOCRACIES AND BETWEEN
THEM AND THE LESS DEVELOPED COUNTRIES.

NEITHER COMMUNIST NATIONS NOR EAST-WEST RELATIONSHIPS
HAVE PLAYED A CENTRAL ROLE IN RECENT INSTITUTIONAL
CHANGES, OR IN DECISIONS AND DEBATES ABOUT THE WORLD
ECONOMIC SYSTEM. THIS IS, IN PART, A MEASURE OF THE
RELATIVE ISOLATION OF THE EAST IN THE WORLD ECONOMY.

MUCH ANALYSIS HAS FOCUSED ON THE NEAR-TERM
IMPLICATIONS OF THE EAST'S RELATIVE INSULATION FROM THE
CONFIDENTIAL

CONFIDENTIAL

PAGE 04 STATE 076239

CURRENT ECONOMIC TROUBLES OF THE WEST. BUT BEYOND THIS
LIE SOME LARGER QUESTIONS. WHAT ARE THE IMPLICATIONS
OF GLOBAL ECONOMIC INSTABILITY FOR THE ECONOMIC
DIMENSION OF EAST-WEST DETENTE? WHAT MIGHT BE THE ROLE
OF THE SOVIETS AND EAST EUROPEANS IN MULTILATERAL
COOPERATIVE EFFORTS AND ARRANGEMENTS? HOW MIGHT THIS
RELATE TO WESTERN INTERESTS AND THE OVERALL EAST-WEST
RELATIONSHIP?

IN WHAT FOLLOWS WE:

-- EXAMINE THE SOVIET AND EASTERN EUROPEAN CALCULUS
OF BENEFIT AND RISK IN ECONOMIC RELATIONS WITH THE WEST;

-- ASSESS THE IMPLICATIONS OF PRESENT AND PROS-

PECTIVE ECONOMIC DEVELOPMENTS FOR EASTERN ECONOMIC
RELATIONS WITH THE WEST;

-- EXAMINE POSSIBLE SOVIET AND EAST EUROPEAN
PARTICIPATION IN CURRENT AND FUTURE INTERNATIONAL ARRANGE-
MENTS IN TRADE AND FINANCE, ENERGY AND FOOD, AND OTHER
COMMODITIES;

-- EVALUATE THE IMPLICATIONS FOR WESTERN INTERESTS
OF A GREATER EASTERN ROLE IN THESE ARRANGEMENTS.

II. THE EASTERN ECONOMIC OPENING TO THE WEST AND DETENTE

A. THE SOVIET AIMS

THE USSR HAS TRADITIONALLY PURSUED A POLICY OF ECONOMIC
INDEPENDENCE, MOTIVATED BY A MIX OF IDEOLOGY, ISOLATIONISM
AND CAPABILITY TO GO IT ALONE IF NEED BE. IT HAS DELIBER-
ATELY INSULATED ITSELF FROM THE WEST AND REMAINED OUTSIDE
THE INTERNATIONAL ECONOMIC SYSTEM AND THE MAJOR INTERNA-
TIONAL TRADE AND MONETARY ORGANIZATIONS. THE VIRTUES OF
THIS POLICY FOR THE SOVIETS HAVE BEEN:

-- SATISFACTION OF MOST OF ITS NEEDS FROM EAST EURO-
PEAN SOURCES FIRMLY UNDER SOVIET POLITICAL CONTROL, AND
CONVERSELY LIMITED VULNERABILITY TO ECONOMIC LEVERAGE
AND INFLUENCE FROM THE WEST;
CONFIDENTIAL

CONFIDENTIAL

PAGE 05 STATE 076239

-- ENHANCED CONTROL OF EAST EUROPE BY LIMITING
INTERACTION WITH THE WEST AND INSURING DEPENDENCE ON THE
USSR FOR CRITICAL RAW MATERIALS AND MANUFACTURES;

-- ISOLATION FROM THE CONTAGIOUS EFFECTS OF WESTERN
IDEAS AND VALUES THAT COULD CREATE PROBLEMS OF CONTROL
FOR THE REGIMES.

WITHIN THIS CONTEXT, THE SOVIET ECONOMIC OPENING TO
THE WEST IS ROOTED IN BROAD SOVIET ECONOMIC AND POLITICAL
CONCERNS. THEIR ECONOMIC OBJECTIVES RELATE TO THE
CENTRAL SOVIET GOAL OF SUSTAINED ECONOMIC GROWTH AND
GREATER EMPHASIS ON THE CONSUMER SECTOR.

-- AS SURPLUS AGRICULTURAL LABOR DWINDLES AND
CONSIDERABLE RESOURCES ARE SHIFTED TO THE CONSUMER SECTOR,
SOVIET INDUSTRY FACES A LONG-RUN DECLINE IN THE SUPPLY OF
CAPITAL AND LABOR THAT HAVE POWERED HIGH GROWTH. SOVIET
CIVILIAN INDUSTRY HAS BEEN PLAGUED BY A LOW LEVEL OF
PRODUCTIVITY AND BY SLOW PROGRESS IN THE APPLICATION OF
MODERN TECHNOLOGY;

-- WESTERN EQUIPMENT, TECHNOLOGY, AND CREDITS ARE SEEN AS SUBSTITUTES FOR THE REDUCTION OF SOVIET INPUTS AND A SHORT CUT TO TECHNOLOGICAL PROGRESS AND ACCELERATED GROWTH IN PRODUCTIVITY;

--DEVELOPMENT OF SOVIET ENERGY RESOURCES IS CRITICAL TO MEET GROWING DOMESTIC ENERGY CONSUMPTION, MAINTAIN THE POLITICALLY ESSENTIAL SUPPLY TO EAST EUROPE, AND PROVIDE EXPORTS FOR HARD CURRENCY EARNINGS. MASSIVE WESTERN PARTICIPATION IS IMPORTANT FOR RAPID DEVELOPMENT GIVEN THE GREAT MAGNITUDE OF THE EFFORT AND SIGNIFICANT TECHNOLOGICAL PROBLEMS WHICH CAN ONLY BE SOLVED QUICKLY WITH KNOW-HOW AVAILABLE IN THE WEST;

-- AS PART OF THEIR CONTINUED ATTENTION TO THE CONSUMER SECTOR, THE SOVIETS HOPE TO SUSTAIN A SHIFT IN FOOD CONSUMPTION PATTERNS TOWARD MORE MEAT AND POULTRY. IN MOST YEARS, THE INEFFICIENT SOVIET AGRICULTURAL SYSTEM
CONFIDENTIAL

CONFIDENTIAL

PAGE 06 STATE 076239

CANNOT MEET THE NEED ON ITS OWN, THOUGH MASSIVE DEVELOPMENT PROGRAMS ARE UNDERWAY. THE SHIFT IN CONSUMPTION CAN ONLY BE SUSTAINED BY IMPORTING LARGE AMOUNTS OF GRAIN FROM THE WEST.

THESE ECONOMIC FACTORS IN TURN ARE RELATED TO BASIC SOVIET POLITICAL OBJECTIVES:

-- ECONOMIC GROWTH AND RISING STANDARDS OF LIVING ARE IMPORTANT TO THE INTERNAL SUCCESS AND STABILITY OF THE REGIME;

-- ADVANCED INDUSTRY AND TECHNOLOGY ARE HALLMARKS OF MODERNITY AND GREAT POWER STATUS FOR THE SOVIETS. YET THE SOVIETS FEAR A WIDENING CIVILIAN TECHNOLOGICAL GAP WITH THE WEST. UNTIL IT CAN BE CLOSED THEY WILL NOT IN THEIR OWN EYES HAVE ACHIEVED THE FULL RANK OF A WORLD SUPER-POWER AND THE "EQUALITY" THEY WANT;

-- LIMITED DIVERSIFICATION OF ECONOMIC RELATIONS TOWARD THE WEST HELPS CONTROL PRESSURES IN EASTERN EUROPE FOR INCREASED ECONOMIC AND POLITICAL CONTACT WITH THE REST OF THE WORLD. MOREOVER, IT OFFERS SOME PROSPECTS OF EASING THE SOVIET BURDEN OF SUPPLYING HARD CURRENCY-EARNING RAW MATERIALS TO EAST EUROPE AND IMPORTING SECOND RATE EAST EUROPEAN MANUFACTURES.

-- THE SOVIETS ALSO SEE ECONOMIC RELATIONS AS AN ELEMENT IN THEIR LARGER POLICY TOWARD THE WEST AND AS AN

INSTRUMENT OF ACCESS AND INFLUENCE.

B. EAST EUROPEAN AIMS

THE EAST EUROPEANS HAVE SIMILAR REASONS FOR DESIRING RELATIVE SELF-SUFFICIENCY WITHIN THE CEMA SYSTEM. THEY DEPEND ON EACH OTHER AND THE SOVIET UNION FOR AS MUCH AS TWO-THIRDS OF THEIR TRADE:

-- THE SYSTEM ENSURES A SECURE SUPPLY OF SUBSTANTIAL RAW MATERIALS AND ENERGY BELOW WORLD PRICES AND WITHOUT HARD CURRENCY COSTS; AND ASSURED MARKETS FOR GOODS THAT

CONFIDENTIAL

PAGE 07 STATE 076239

WOULD FIND NO READY TAKERS OUTSIDE THE SYSTEM;

-- THE EAST EUROPEANS HAVE ALSO BEEN SENSITIVE, THOUGH TO VARYING DEGREES, TO THE LEVERAGE AND DESTABILIZING INFLUENCES WHICH EXPOSURE TO THE WEST MIGHT ENTAIL.

YET THEY HAVE PARTICIPATED MORE IN THE WESTERN INTERNATIONAL ECONOMIC SYSTEM AND ITS INSTITUTIONS THAN THE SOVIETS. AND IN SOME WAYS THEIR INTEREST IN LONG-TERM STABLE ACCESS TO WESTERN EQUIPMENT, TECHNOLOGY AND CREDITS IS GREATER THAN THE SOVIETS:

-- LACKING TO VARYING DEGREES THE SOVIET CAPITAL, LABOR, AND RESOURCES BASE, SUSTAINED ECONOMIC GROWTH AND SATISFACTION OF CONSUMER DEMAND IS EVEN MORE CLOSELY TIED TO THE ENHANCED PRODUCTIVITY THAT WESTERN TECHNOLOGY AND EQUIPMENT CAN HELP PROVIDE;

-- A RISING STANDARD OF LIVING IS A MUCH MORE IMPORTANT PRECONDITION FOR POLITICAL STABILITY AND THE CONTINUED HOLD OF THE COMMUNIST PARTIES IN EASTERN EUROPE. PAST UPRISINGS AND TURMOIL STEMMED IN PART FROM ECONOMIC DISSATISFACTION;

-- DIVERSIFICATION OF ECONOMIC RELATIONS TOWARD THE WEST ALSO OFFERS SOME POSSIBILITY OF MORE POLITICAL LEE-WAY AND LESSER ECONOMIC DEPENDENCE ON THE SOVIET UNION.

C. WESTERN AIMS

THE WEST HAS SOME INTEREST IN ACCESS TO SOVIET RAW MATERIALS AND MARKETS. BUT EAST-WEST ECONOMIC EXCHANGE DOES NOT COUNT AS MUCH IN BASIC ECONOMIC POLICIES AS IT DOES FOR THE EAST. ECONOMIC EXCHANGE WITHIN THE INDUSTRIAL NON-COMMUNIST WORLD IN THE FIRST INSTANCE AND BETWEEN IT AND THE LESS DEVELOPED COUNTRIES IN THE SECOND IS OBVIOUSLY PARAMOUNT IN THE ECONOMIC GROWTH AND WELL-BEING

OF THE WEST.

FOR THE WEST, THE POSSIBLE POLITICAL BENEFITS HAVE BEEN AN IMPORTANT DIMENSION OF THE ECONOMIC RELATIONSHIP WITH THE EAST. INCREASED ECONOMIC CONTACTS OFFER SOME
CONFIDENTIAL

CONFIDENTIAL

PAGE 08 STATE 076239

PROSPECT OF ENHANCED INFLUENCE ON THE EAST THROUGH THE ABILITY TO PROVIDE OR WITHHOLD ECONOMIC COUNTERS. THEY HELP CREATE ADDITIONAL TIES OF MUTUAL INTEREST AND OBLIGATIONS THAT ADD AN ELEMENT OF RESTRAINT AND STABILITY TO THE POLITICAL EQUATION.

IF THERE ARE RISKS FOR THE EAST IN GROWING ECONOMIC EXCHANGE AND INTERDEPENDENCE, SO ARE THERE FOR THE WEST.

THERE IS CONCERN THAT SOVIET ACCESS TO THE WEST COULD FREE ECONOMIC RESOURCES AND PROVIDE TECHNOLOGY WHICH COULD BE APPLIED TO MILITARY PROGRAMS. WESTERN DEPENDENCE ON THE EAST FOR IMPORTANT MARKETS OR RAW MATERIAL SUPPLIES COULD BRING GREATER VULNERABILITY TO SOVIET POWER AND LEVERAGE. MOREOVER, DIVISIVE WESTERN COMPETITION FOR ECONOMIC ACCESS TO THE EAST MIGHT ENHANCE SOVIET LEVERAGE AND ABILITY TO PLAY THE GAME OF SELECTIVE DETENTE IN THE ECONOMIC ARENA.

III. EAST-WEST TRADE, FINANCE AND MULTILATERAL ARRANGEMENTS

THE EASTERN ECONOMIES HAVE BEEN PROTECTED FROM THE EFFECTS OF THE DOUBLE-BARREL BOOM BUST IN THE WESTERN ECONOMIES BY THEIR RELATIVE ISOLATION FROM THE WORLD ECONOMIC SYSTEM. THEIR ADMINISTERED PRICE SYSTEM HAS HELPED THEM AVOID THE DOUBLE-DIGIT INFLATION OF 1972-73 AND THE SHARP RECESSION OF 1974-75. HOWEVER, GLOBAL ECONOMIC INSTABILITY HAS HAD AN EFFECT ON COMMUNIST ECONOMIC AIMS WITH THE WEST AND THEIR ABILITY TO PURSUE THEM.

A. WORLD ECONOMIC INSTABILITY AND THE PROSPECTS FOR EAST-WEST TRADE AND FINANCE

IN THE NEAR-TERM, WORLD ECONOMIC INSTABILITY HAS BROUGHT THE SOVIETS A MIX OF GAINS AND LOSSES IN THEIR ECONOMIC AIMS VIS-A-VIS THE WEST. BUT THE BALANCE IS CLEARLY NEGATIVE FOR THE EAST EUROPEANS NOT ONLY WITH THE WEST BUT WITH THE SOVIET UNION AS WELL.

CONFIDENTIAL

CONFIDENTIAL

PAGE 09 STATE 076239

1. THE SOVIET UNION

SOVIET ACCESS TO WESTERN EQUIPMENT, TECHNOLOGY AND CREDITS HAS BEEN ENHANCED IN A NUMBER OF WAYS;

-- MOSCOW'S TERMS-OF-TRADE ARE SIGNIFICANTLY IMPROVED OVER 1972. RAPID INCREASE IN SOVIET OIL AND RAW MATERIAL EXPORT PRICES IN 1973-74 HAS FAR OUTWEIGHED THE HIGHER PRICES OF SOVIET IMPORTS OF MANUFACTURES FROM THE WEST. THE DOLLAR VALUE OF SOVIET EXPORTS TO THE WEST ROSE BY MORE THAN 50 PERCENT IN 1973 AND INCREASED SUBSTANTIALLY IN 1974. FROM A DEFICIT OF \$1.7 BILLION IN 1973, THE SOVIET HARD CURRENCY SURPLUS WAS IN THE \$1 BILLION RANGE IN 1974, THE FIRST SUCH SURPLUS IN SEVEN YEARS AND ONLY THE SECOND IN 15 YEARS;

-- APPRECIATION IN VALUE OF SOVIET GOLD HOLDINGS IN RECENT YEARS HAS ALSO SUBSTANTIALLY ENHANCED THE USSR'S IMPORT CAPACITY. AT THE 1975 PRICE OF ABOUT \$180 AN OUNCE, SOVIET GOLD RESERVES ARE WORTH ABOUT \$10 BILLION, WELL IN EXCESS OF THE APPROXIMATELY \$6.5 BILLION WORTH OF SOVIET HARD CURRENCY IMPORTS IN 1974. MOREOVER, SOVIET GOLD PRODUCTION IS RISING RAPIDLY; ONE PROJECTION INDICATES THAT THE VALUE OF ANNUAL OUTPUT (AT \$180 AN OUNCE) WILL CLIMB FROM ABOUT \$1.7 BILLION IN 1975 TO ABOUT \$3 BILLION IN 1985;

-- RECENT DECLINE IN DEMAND AND PRICES FOR SOME SOVIET COMMODITY EXPORTS -- E.G., PLATINUM, DIAMONDS, COPPER AND WOOD -- WILL PROBABLY RESULT IN LOWER EARNINGS WHICH SHOULD CONTINUE THROUGH 1975. BUT GOLD, OIL, GAS, AND COAL PRICES WILL REMAIN HIGH ENOUGH TO MAKE ANOTHER HARD CURRENCY SURPLUS IN 1975 PROBABLE;

-- DEEPENING WESTERN RECESSION IS MARKEDLY SLOWING THE RISE OF WESTERN EXPORT PRICES. THE SOVIETS WILL BENEFIT DIRECTLY, PARTICULARLY SINCE THEY ARE IN THE PROCESS OF PLACING SEVERAL BILLION DOLLARS OF ORDERS IN SUPPORT OF THE 1976-80 PLAN;

-- THE SOVIETS MAY FEEL THAT DEPRESSED MARKET CONDITIONS IN THE WEST MAKE THE SOVIET MARKET MORE ATTRACTIVE AND HAVE ENHANCED THEIR LEVERAGE TO SECURE LOW-INTEREST CREDITS AND LONG-TERM COMMODITY PAY-BACK DEALS FROM THE

CONFIDENTIAL

PAGE 10 STATE 076239

TIONS IN THE WEST MAKE THE SOVIET MARKET MORE ATTRACTIVE AND HAVE ENHANCED THEIR LEVERAGE TO SECURE LOW-INTEREST CREDITS AND LONG-TERM COMMODITY PAY-BACK DEALS FROM THE

WEST.

AT THE SAME TIME WORLD ECONOMIC CONDITIONS HAVE RESULTED IN FACTORS WHICH MIGHT OFFSET SOME OF THE BENEFITS GAINED BY THE SOVIETS IN THEIR ECONOMIC RELATIONS WITH THE WEST:

-- ALTHOUGH IT IS NOW SLOWING, WESTERN INFLATION HAS PROPELLED PRICES VERY MUCH HIGHER THAN THE SOVIETS COUNTED ON IN THEIR PLANNING. IN SOME INSTANCES THEY HAVE BEEN FORCED TO ACCEPT PRICE ESCALATION CLAUSES IN PURCHASE CONTRACTS. IN OTHERS THEY HAVE HAD TO AGREE TO SUBSTANTIAL PRICE INCREASES FOR THE SAKE OF CONTINUED BUSINESS RELATIONS. PRICE INSTABILITY HAS HAD SOME DISRUPTIVE EFFECT ON ALLOCATION AND INVESTMENT DECISIONS AND FORCED NEW CALCULATIONS ON SPECIFIC PROJECTS.

-- RECENT DECLINES IN RAW MATERIALS PRICES ARE UNDERMINING THE RECENT SOVIET IMPROVEMENT IN THE USSR'S TERMS OF TRADE. WITH SOVIET IMPORTS INCREASING AT A RAPID RATE, THE REEMERGENCE OF A TRADE DEFICIT IS A DISTINCT

POSSIBILITY. THIS WILL BE OFFSET PARTLY BY THE INCREASED SOVIET ABILITY TO BORROW HEAVILY WITHOUT INCURRING AN UNMANAGEABLE DEBT-SERVICE BURDEN.

2. EAST EUROPE

EASTERN EUROPE'S ABILITY TO IMPORT WESTERN EQUIPMENT AND TECHNOLOGY AND TO EXPAND ITS EXPORT MARKETS IN THE WEST HAS RECEIVED A SHARP AND IN SOME ASPECTS LONG-TERM SETBACK:

-- IN 1974 THE TERMS OF TRADE DECLINED FOR ALL EAST EUROPEAN COUNTRIES, THOUGH ROMANIA AND POLAND FARED MUCH BETTER BECAUSE OF THEIR FUEL AND RAW MATERIAL EXPORTS. HIGHER WESTERN EXPORT PRICES OUTSTRIPPED THE RISE IN PRICES FOR EAST EUROPEAN EXPORTS TO THE WEST. IN ADDITION, EASTERN

CONFIDENTIAL

PAGE 11 STATE 076239

EUROPEAN EXPORTS SLUMPED BADLY BECAUSE OF RECESSION IN THE WEST.

-- THE RESULT HAS BEEN A COMBINED EAST EUROPEAN DEFICIT OF \$4.4 BILLION IN 1974, NEARLY TWICE THE DEFICIT OF 1973, WITH ANOTHER SIZEABLE DEFICIT IN THE OFFING FOR 1975. FOR SOME EAST EUROPEAN COUNTRIES, IMPORTS FROM THE WEST WILL BE EVEN MORE DEPENDENT ON COMMITMENTS FOR FURTHER CREDITS TO COVER ANTICIPATED DEFICITS;

-- INCREASED PRICES FOR SOVIET RAW MATERIALS AND THE

NEED TO BOOST EXPORTS TO THE SOVIET UNION WILL PLACE FURTHER STRAIN ON THE EAST EUROPEAN ECONOMIES AND CONSTRAINTS ON THEIR ABILITY TO TRADE WITH THE WEST.

3. SOVIET-EAST EUROPE RELATIONS

WORLD ECONOMIC CONDITIONS HAVE ALSO BROUGHT THE SOVIETS SIGNIFICANT GAINS RELATIVE TO EASTERN EUROPE, ALTHOUGH THE SOVIETS MAY BE APPREHENSIVE THAT POLITICAL INSTABILITY COULD RESULT IF EASTERN EUROPEAN DEVELOPMENT PLANS ARE NOT FULFILLED. OVERALL COMMUNIST UNITY COULD ALSO BE ENDANGERED IF THE NEED FOR CREDITS DROVE THE EAST EUROPEANS CLOSE TO THE WEST.

FOR YEARS, THE USSR HAS BEEN UNHAPPY OVER ITS TERMS OF TRADE WITH EASTERN EUROPE, SELLING HIGH COST RAW MATERIALS AT LOW PRICES FOR WHAT IT CONSIDERED OVERPRICED MACHINERY AND EQUIPMENT. TO OFFSET THIS THE USSR HAS INSISTED IN RECENT YEARS THAT THE EASTERN EUROPEANS BUY MORE SOVIET MACHINERY, BUY MORE OIL IN THE WEST, AND INVEST IN SOVIET RAW MATERIAL PROJECTS AS A GUARANTEE FOR FUTURE DELIVERIES. THE RISE IN WORLD OIL AND RAW MATERIAL

PRICES ENABLED THE SOVIETS TO BOOST PRICES TO THE EAST EUROPEANS, THOUGH NOT TO WORLD LEVELS, THUS IMPROVING ITS TERMS OF TRADE.

EASTERN EUROPEAN TERMS OF TRADE HAVE DETERIORATED WITH RESPECT TO BOTH THE WEST AND THE SOVIETS, ALTHOUGH THE DETERIORATION WITH THE SOVIETS WAS NOT AS SEVERE. DESPITE SOVIET PRICE INCREASES FOR ENERGY AND RAW MATERIALS, THEY

CONFIDENTIAL

CONFIDENTIAL

PAGE 12 STATE 076239

ARE STILL BELOW WORLD PRICE LEVELS FOR MANY IMPORTANT COMMODITIES. THUS, THE RELATIVE ADVANTAGE OF DOING BUSINESS WITH THE SOVIETS RATHER THAN THE WEST HAS INCREASED. THIS HAS GIVEN THE SOVIETS ENHANCED LEVERAGE TO INCREASE EAST EUROPEAN INVOLVEMENT IN THE DEVELOPMENT OF THE SOVIET ECONOMY, ESPECIALLY RESOURCE DEVELOPMENT, AND TO BIND THE EAST EUROPEANS MORE FULLY INTO THE CEMA SYSTEM.

B. EASTERN PARTICIPATION IN WESTERN MULTILATERAL TRADE AND FINANCIAL ARRANGEMENTS

UNTIL NOW, THE ECONOMIC ASPECTS OF DETENTE HAVE BEEN REGULATED ESSENTIALLY ON A BILATERAL BASIS, OFTEN ON A ONE-FOR-ONE BARTER OR CREDIT BASIS. STRICT REGULATIONS AGAINST FOREIGN PARTICIPATION IN EQUITY VENTURES AIMED AT THE DOMESTIC MARKET CONTINUE. THE TRADITIONAL METHODS OF EAST-WEST TRADE, THEREFORE, HAVE NOT BEEN SIGNIFICANTLY

ALTERED DESPITE INCREASED CONTACTS WITH THE WEST. APPARENTLY, THE SOVIETS HAVE NOT BELIEVED IT EITHER NECESSARY OR IN THEIR INTEREST TO CONDUCT THEIR ECONOMIC CONTACTS IN A MULTILATERAL CONTEXT. THEY HAVE JOINED NO WESTERN FINANCIAL OR TRADING ARRANGEMENTS (ALTHOUGH A FEW EASTERN EUROPEAN COUNTRIES HAVE) AND THEY HAVE NOT REVEALED ANY NEAR-TERM PLANS FOR CONVERTIBILITY OF THE RUBLE OR OTHER EASTERN CURRENCIES.

THERE ARE A NUMBER OF DEVELOPMENTS, HOWEVER, WHICH SUGGEST GROWING SOVIET AND EASTERN INTEREST IN INVOLVEMENT IN MULTILATERAL TRADE AND FINANCIAL ARRANGEMENTS.

-- THE SOVIETS ARE STUDYING THE POSSIBILITY OF THEIR PARTICIPATION IN MAJOR INTERNATIONAL TRADING INSTITUTIONS SUCH AS THE GENERAL AGREEMENT ON TARIFFS AND TRADE (THE GATT) AND PARTICULARLY IN THE MULTILATERAL TRADE NEGOTIATIONS (MTNS) IN GENEVA.

-- LARGELY UNDER SOVIET IMPULSE, CEMA IS SEEKING TO DEVELOP A FORMAL AND VISIBLE RELATIONSHIP WITH THE EUROPEAN COMMUNITY. AN IMPORTANT REASON IS EAST EUROPE'S NEED TO COME TO GRIPS WITH THE EUROPEAN COMMUNITY'S COMMON COMMERCIAL POLICY. PROBABLY MORE IMPORTANT IS ESTABLISH-CONFIDENTIAL

CONFIDENTIAL

PAGE 13 STATE 076239

MENT OF CEMA AS AN ORGANIZATION OF EQUAL STATUS AND PRESTIGE AS THE EUROPEAN COMMUNITY.

-- THE EAST HAS MADE INCREASING USE OF COMECON BANKS FOR FINANCIAL CONTACTS WITH THE WEST. THE CEMA INTERNATIONAL INVESTMENT BANK REPORTEDLY WANTS TO BORROW A LARGE SUM ON THE EURODOLLAR MARKET TO HELP FINANCE A GAS PIPELINE BETWEEN THE SOVIET UNION AND EASTERN EUROPE.

-- IN CSCE, THE EASTERN COUNTRIES HAVE SHOWN AN ACTIVE INTEREST IN THE SO-CALLED "SECOND BASKET" ISSUES INVOLVING EAST-WEST EXCHANGE OF GOODS AND TECHNOLOGY. THE SOVIETS HAVE BEEN INCREASINGLY WILLING TO ENTRUST IMPLEMENTATION OF SOME "SECOND BASKET" DECISIONS TAKEN AT THE CSCE TO THE UN'S ECONOMIC COMMISSION ON EUROPE.

ALTHOUGH THERE ARE THESE AND OTHER TENTATIVE INDICATIONS OF EASTERN INTEREST IN PARTICIPATION IN TRADE AND FINANCIAL INSTITUTIONS, SUBSTANTIAL OBSTACLES REMAIN. THE COMMUNIST ECONOMIC STRUCTURE IS STILL FAR TOO LITTLE DEPENDENT ON PRICES AND THEY HAVE NO MEANINGFUL SYSTEM OF FINANCIAL MARKETS AND INSTITUTIONS. SINCE BASIC STRUCTURAL ELEMENTS OF THEIR ECONOMIES WILL NOT BE MODIFIED IN THE NEAR TERM, REASONABLE BASES FOR THEIR

PARTICIPATION WILL REMAIN DIFFICULT TO NEGOTIATE.

THESE FACTORS MAY BEAR PARTICULARLY ON PARTICIPATION IN THE GATT, THE IMF AND THE WORLD BANK. IT WOULD BE DIFFICULT FOR CENTRALLY PLANNED ECONOMIES, PARTICULARLY THE SOVIETS, TO FOLLOW THE GATT PRECEPTS OF MULTILATERALISM AND NON-DISCRIMINATION, ALTHOUGH HUNGARY, POLAND, CZECHOSLOVAKIA, AND ROMANIA OSTENSIBLY ASCRIBE TO GATT PRINCIPLES.

THE SOVIETS MIGHT, HOWEVER, WANT TO JOIN THE MULTILATERAL TRADE NEGOTIATIONS WITHOUT GATT MEMBERSHIP. THE DOOR HAS BEEN LEFT OPEN FOR NON-GATT COUNTRIES TO BE INVOLVED IN THE MTNS. ALTHOUGH THE SOVIETS MIGHT PARTICIPATE USEFULLY IN SOME ASPECTS OF THE NEGOTIATIONS THEIR INTEREST AND USEFULNESS IN TARIFF NEGOTIATIONS WOULD BE MINIMAL. SOVIET EMPHASIS ON BLOC SOLIDARITY
CONFIDENTIAL

CONFIDENTIAL

PAGE 14 STATE 076239

MAY HAVE A DAMPENING EFFECT ON THE NEGOTIATING FLEXIBILITY OF THE EAST EUROPEAN COUNTRIES. MEANINGFUL CONCESSIONS BY THE SOVIETS WOULD BE DIFFICULT TO FORMULATE.

ONE OF THE PILLARS OF THE IMF SYSTEM IS THE CONCEPT OF CONVERTIBLE CURRENCIES. IN ORDER TO JOIN THE IMF, THE SOVIETS WOULD BE REQUIRED TO WORK TOWARD CONVERTIBILITY, ALTHOUGH THEY MIGHT WANT TO CONVERT THE RUBLE FOR OTHER REASONS. ALTHOUGH A DECISION TO MAKE EASTERN CURRENCIES

CONVERTIBLE WOULD BE DIFFICULT AND UNLIKELY IN THE NEAR-TERM, FOR THE COMMUNIST NATIONS, IT MIGHT IMPROVE THE SOVIETS STANDING IN INTERNATIONAL FINANCIAL MARKETS AND GIVE THEM BETTER ACCESS TO PRIVATE CREDITS. IT WOULD RELIEVE THEM OF THEIR CONSTANT CONCERN FOR THE NEED TO EARN HARD CURRENCIES. SOVIET GOLD RESERVES OF \$10 BILLION COULD EASILY BE CONVERTED TO MONETARY RESERVES AND PLACE THEM IN A VERY STRONG POSITION TO DEFEND A CONVERTIBLE RUBLE.

SOVIET MEMBERSHIP IN THE IMF WOULD ENHANCE THEIR INTERNATIONAL ECONOMIC PRESTIGE AND GIVE THEM ACCESS TO ADDITIONAL WESTERN CREDITS. IT WOULD ALSO OPEN UP THE SOVIET ECONOMY TO OUTSIDE SCRUTINY, WHICH THEY WOULD PROBABLY FIND DIFFICULT TO ACCEPT.

SOVIET IMF MEMBERSHIP, HOWEVER, WOULD CAUSE PROBLEMS FOR THE WEST BY ALTERING THE DELICATELY BALANCED VOTING STRUCTURE IN THE FUND. WESTERN CONTROL OVER THE PACE AND STRUCTURE OF INTERNATIONAL MONETARY REFORM EFFORTS WOULD BE DIMINISHED.

IF THE SOVIETS WERE TO BECOME MEMBERS OF THE WORLD BANK, THEY WOULD BE COMMITTED TO PROVIDE THEIR SHARE OF RESOURCES FOR THE DEVELOPMENT OF POOR COUNTRIES. SOVIET GAINS WOULD RESULT LARGELY FROM ASSOCIATION WITH THE INTERNATIONAL PRESTIGE OF THIS INSTITUTION. PERHAPS THEIR IMAGE WITH THE THIRD WORLD COUNTRIES WOULD BE ENHANCED. SOVIET MEMBERSHIP IN THE BANK WOULD GIVE THEM VOTING POWER IN PROPORTION TO THEIR FINANCIAL CONTRIBUTION. THEIR VOTING INFLUENCE COULD CHANGE THE DISTRIBUTION OF
CONFIDENTIAL

CONFIDENTIAL

PAGE 15 STATE 076239

BANK LENDING: A GREATER PROPORTION OF LOANS MIGHT GO TO COUNTRIES FRIENDLY TO THE SOVIET UNION. THE WEST WOULD HAVE LESS ABILITY TO SHAPE BANK DECISIONS TOWARD WESTERN POLITICAL ENDS.

IV. SOVIET OIL AND PARTICIPATION IN ENERGY ARRANGEMENTS

EVENTS OF THE LAST TWO YEARS HAVE HIGHLIGHTED THE IMPORTANCE OF IMPORTED OIL TO THE NATO COUNTRIES. ALTHOUGH THE UNITED STATES PRODUCES A LARGE PART OF ITS OWN REQUIREMENTS, IT IMPORTS NEARLY 40 PER CENT. THE EUROPEAN COUNTRIES DEPEND ON IMPORTS FOR 97 PER CENT OF THEIR OIL NEEDS, ALTHOUGH THIS WILL CHANGE AS THE NORTH SEA DEPOSITS ARE MORE FULLY EXPLOITED. WHILE MOST US IMPORTS COME FROM THE WESTERN HEMISPHERE, WESTERN EUROPE IMPORTS MOST OF ITS OIL FROM ARAB PRODUCERS.

THE ARAB OIL EMBARGO AND THE QUADRUPLING OF OIL PRICES IN LESS THAN A YEAR AFTER THE OCTOBER 1973 MIDDLE EAST WAR LEVIED SUBSTANTIAL ECONOMIC COSTS ON THE NON-COMMUNIST INDUSTRIAL WORLD. THE OIL CRISIS FUELED INFLATION AND HELPED PRECIPITATE THE 1974-75 RECESSION.

THE WEST HAS RESPONDED TO THE OIL CRISIS BY WORKING FOR SOLIDARITY AMONG CONSUMING NATIONS. THE INTERNATIONAL ENERGY AGENCY GREW OUT OF CONSUMER DESIRES FOR A COOPERATIVE OIL SAFETY NET TO HELP WITHSTAND A FUTURE OIL EMBARGO. THE AGENCY HAS BEEN THE FOCAL POINT FOR CONSUMER COOPERATION ON A FINANCIAL SAFETY NET, ENERGY CONSERVATION AND THE DEVELOPMENT OF ALTERNATIVE ENERGY SUPPLIES.

A DIALOGUE BETWEEN OIL PRODUCERS AND CONSUMERS HAS NOW BEGUN. A PREPARATORY CONFERENCE, HELD EARLY THIS MONTH, WILL BE FOLLOWED BY A PRODUCER/CONSUMER CONFERENCE LATER THIS YEAR. THE CONFERENCE WILL DISCUSS NOT ONLY OIL PRICE AND SECURITY OF SUPPLY BUT OTHER ISSUES SUCH AS RECYCLING, AID TO LESS DEVELOPED COUNTRIES,

ONWARD INVESTMENT, AND INDUSTRIALIZATION OF THE
PRODUCING COUNTRIES.

CONFIDENTIAL

CONFIDENTIAL

PAGE 16 STATE 076239

A. SOVIET OIL POSITION AND POLICY

IN CONTRAST TO THE WEST, THE USSR IS SELF-SUFFICIENT
IN ENERGY. OIL IS THE USSR'S MAJOR EXPORT; THEY ARE AN
IMPORTANT FACTOR IN THE WORLD OIL PICTURE. WITH THE
DECLINE IN UNITED STATES PRODUCTION IN THE LAST TWO YEARS
AND RECENT DECLINES IN SAUDIA ARABIA, THE RUSSIANS HAVE
BECOME THE WORLD'S LARGEST PRODUCER OF OIL AND EXPECTED
1975 EXPORTS OF 2.7 MILLION B/D PLACE THEM BEHIND ONLY
SAUDI ARABIA AND IRAN. MORE THAN HALF OF THEIR EXPORTS
WILL BE DIRECTED TO COMMUNIST COUNTRIES.

THE SOVIET POLICY HAS BEEN TO PRODUCE AS MUCH OIL
AS POSSIBLE -- TO MEET THEIR OWN NEEDS, TO KEEP THE
EASTERN EUROPEANS DEPENDENT ON THEM FOR ENERGY SUPPLIES,
AND TO EARN HARD CURRENCY.

-- SOVIET POTENTIAL FOR INCREASED OIL EXPORTS IS
LIMITED, HOWEVER. THEY ARE EXPECTED TO MEET THE GROWTH
IN DEMAND BUT EXPORTS WILL PROBABLY GROW VERY LITTLE
BETWEEN NOW AND 1980.

-- THE GROWING DEPLETION OF RESOURCES AVAILABLE NEAR
EASTERN POPULATION CENTERS HAS FORCED THE SOVIET LEADER-
SHIP TO LOOK TOWARD SIBERIA FOR NEW RESERVES. DEVELOP-
MENT WILL BE COSTLY BECAUSE OF COLD CLIMATE ENGINEERING
PROBLEMS AND DISTANCES FROM MARKETS. BY 1990 SIBERIAN
FIELDS ARE EXPECTED TO ACCOUNT FOR ONE-HALF OF SOVIET
PRODUCTION OF OIL AND GAS.

-- IN ORDER TO MINIMIZE THE HARD CURRENCY LOSS FROM
POSSIBLE SHORTFALLS IN ENERGY DEVELOPMENT, MOSCOW WILL
WISH TO ARRANGE MORE BARTER OIL DEALS WITH MIDDLE EASTERN
COUNTRIES. THE IRAQIS, HOWEVER, RECENTLY HAVE RESISTED
SOVIET REQUESTS FOR BARTER OIL TO SUPPLY EASTERN EUROPE.

ALTHOUGH SOVIET OIL EXPORTS ARE NOT LIKELY TO GROW,
LARGER SUPPLIES OF NATURAL GAS SHOULD BE AVAILABLE FOR
EXPORT OVER THE NEXT FIVE YEARS. SOVIET GAS RESERVES ARE
MUCH LARGER THAN THOSE FOR OIL, BUT THE EQUIPMENT AND
TECHNOLOGY REQUIRED TO PRODUCE THE GAS FROM FIELDS LOCATED
CONFIDENTIAL

CONFIDENTIAL

PAGE 17 STATE 076239

IN REMOTE AREAS AND TO TRANSPORT IT BY PIPELINE IS COSTLY. MUCH OF THE EQUIPMENT AND FINANCING MUST COME FROM THE WEST, BUT A NEW COOPERATIVE GAS DEVELOPMENT VENTURE IS UNDER WAY WITH FIVE EAST EUROPEAN COUNTRIES.

ALTHOUGH SOVIET COAL EXPORTS ARE EXPECTED TO DECLINE THIS YEAR, BOTH RUSSIAN AND POLISH EXPORTS ARE EXPECTED TO EXPAND SHARPLY AFTER 1975.

B. SOVIET GAINS FROM THE ENERGY CRISIS

AS A MAJOR OIL EXPORTER, THE SOVIET UNION HAS OBTAINED SUBSTANTIAL SHORT-TERM ADVANTAGE FROM THE ENERGY CRISIS AND HIGH OIL PRICES:

-- IN 1974 OIL EARNINGS DOUBLED TO AT LEAST \$3.5 BILLION, AND OIL REVENUES SHOULD BE AT LEAST AS GREAT IN 1975, THUS HELPING ASSURE THE SOVIETS ANOTHER HARD CURRENCY SURPLUS.

-- THE EASTERN EUROPEANS HAVE BECOME EVEN MORE DEPENDEN

ON SOVIET OIL, STILL PRICED BELOW WORLD LEVELS. EXCLUDING ROMANIA, WHICH DOES NOT IMPORT SOVIET OIL, THE REMAINING FIVE COUNTRIES OF EASTERN EUROPE RELY ON THE USSR FOR ABOUT 85 PER CENT OF THEIR OIL SUPPLIES.

-- THE CRISIS GAVE THE SOVIETS THE OCCASION TO BOOST THE PRICE FOR MOST OIL DELIVERIES TO THE EAST FROM \$3 A BARREL TO ABOUT \$7, BEFORE THE END OF THE CURRENT FIVE-YEAR PLAN. EASTERN EUROPE'S BILL FOR SOVIET OIL WILL INCREASE BY \$1.5 BILLION -- EQUIVALENT TO ABOUT 13 PER CENT OF ITS EXPORTS TO THE USSR IN 1974. THIS IS A MAJOR FACTOR IN WORSENING EASTERN EUROPE'S TERMS OF TRADE WITH THE USSR AND ITS OVER-ALL ECONOMIC PLIGHT.

C. THE LONG-TERM COST TO THE SOVIET UNION

ALTHOUGH THE ENERGY CRISIS BROUGHT SUBSTANTIAL SHORT-TERM ADVANTAGES TO THE SOVIET UNION, IT MAY HAVE COME AT SUBSTANTIAL LONG-TERM COST.

CONFIDENTIAL

CONFIDENTIAL

PAGE 18 STATE 076239

-- THE ENERGY CRISIS HAS INFLICTED A SHARP SETBACK TO SOVIET HOPES FOR MASSIVE WESTERN PARTICIPATION IN DEVELOPMENT OF ENERGY RESOURCES, PARTICULARLY THE SOVIET RESERVES IN SIBERIA WHICH ARE CRUCIAL FOR FUTURE CONSUMPTION AND EXPORT NEEDS.

-- THE REQUIRED FINANCE, EQUIPMENT, TECHNOLOGY, AND KNOW-HOW ARE NOW SCARCE IN THE WEST. INTEREST BY WESTERN FIRMS IN A NUMBER OF SOVIET PROJECTS HAS BEEN MUTED.

-- AND, MORE IMPORTANTLY, DEVELOPMENT OF ENERGY RESOURCES ON SOVIET SOIL RUNS UP AGAINST WESTERN PRIORITIES TO INSURE ADEQUATE INVESTMENT IN MORE SECURE ENERGY SOURCES.

-- LONG TERM SOVIET ENERGY PLANS HAVE BEEN SET BACK A NUMBER OF YEARS.

CLEARLY THE WEST WILL CONTINUE TO GIVE PRIORITY TO ENERGY DEVELOPMENT WITHIN THE WESTERN CONSUMING NATIONS FOR SOME TIME. HOWEVER, ONCE THE CURRENT ECONOMIC CRISIS IS PAST AND ASSUMING AVAILABILITY OF CAPITAL AND EQUIPMENT FOR ENERGY DEVELOPMENT IN THE WEST, IT COULD BE IN OUR MUTUAL INTEREST TO FACILITATE COOPERATIVE ENDEAVORS IN THE ENERGY FIELD IF THEY DO NOT CONFLICT WITH OUR SECURITY GOALS.

EXPANSION OF SOVIET ENERGY SUPPLIES COULD HAVE AN IMPORTANT INFLUENCE ON THE MARKET FOR OIL. A MAJOR SHORTFALL IN THEIR EXPORTS TO EASTERN EUROPE, CUBA, OR HARD CURRENCY AREAS WOULD INCREASE THE MARKET FOR OPEC OIL. IT WOULD HELP SUSTAIN OIL HIGH PRICES AND RAPID ACCUMULATION OF OPEC ASSETS.

AT THE SAME TIME, THE WEST MUST BE CONCERNED ABOUT VERY RAPID DEVELOPMENT, IF IN THE PROCESS THEY BECOME MORE DEPENDENT ON SOVIET ENERGY, PARTICULARLY LIQUID NATURAL GAS.

D. THE SOVIET ROLE IN INTERNATIONAL ENERGY
CONFIDENTIAL

CONFIDENTIAL

PAGE 19 STATE 076239

ARRANGEMENTS

THE USSR AND THE EASTERN EUROPEANS HAVE NOT BEEN ACTIVE IN INTERNATIONAL ENERGY DELIBERATIONS. THEY HAVE NOT PARTICIPATED IN ANY OF THE DISCUSSIONS LEADING TO THE FORMATION OF THE INTERNATIONAL ENERGY AGENCY. NOR HAVE THEY BEEN INVOLVED IN THE PRODUCER/CONSUMER PREPARATORY CONFERENCE.

YET THERE ARE SOME INDICATIONS OF SOVIET INTEREST IN INTERNATIONAL ENERGY ARRANGEMENTS AND DISCUSSIONS.

-- THEY COULD SEEK TO ASSOCIATE THEMSELVES WITH THE PRODUCER/CONSUMER STRUCTURE TO SERVE THEIR INTERESTS IN HIGH PRICES AND PROTECTION FROM INFLATION;

-- THEY COULD ATTEMPT TO LEGITIMIZE THEIR CLAIM TO PARTICIPATION BY POINTING TO THEIR IMPORTANCE IN WORLD OIL PRODUCTION AND TRADE;

-- AT THE LEAST, THEY WILL WANT TO KEEP THEMSELVES INFORMED AND PRESERVE THEIR OPTIONS TO BLOCK DEVELOPMENTS CONSIDERED TO BE INIMICAL TO THEIR HARD-WON INTERESTS IN WORLD TRADE.

SOVIET PARTICIPATION IN THE PRODUCER/CONSUMER DIALOGUE WOULD RAISE PROBLEMS FOR THE WEST. AS A MAJOR EXPORTER, THE SOVIETS HAVE BEEN A SUBSTANTIAL BENEFICIARY OF OPEC ACTIONS. THEY SHARE PRODUCERS INTERESTS IN HIGH OIL PRICES AND IN LOW PRICES FOR CAPITAL GOODS AND FOOD FROM THE WEST. THEY MAY DESIRE TO POSE AS DEFENDER OF LDC INTERESTS BY ARGUING FOR INCLUSION OF COMMODITIES IN THE DIALOGUE AND BY URGING HIGHER PRICES FOR THEM AS WELL, FOLLOWING THE ALGERIAN LINE. THE WEST MIGHT SEE SOME ADVANTAGE IN SOVIET PARTICI-

PATION IN INTERNATIONAL ENERGY ARRANGEMENTS AT SOME POINT. IT COULD ADD AN ELEMENT OF CONSTRAINT TO OVERALL SOVIET INTERNATIONAL BEHAVIOR; AND THE WEST COULD BRING TO BEAR LEVERS TO CONTROL THE NATURE OF SOVIET INVOLVEMENT, SUCH AS ACCESS TO WESTERN CREDITS AND ENERGY

CONFIDENTIAL

CONFIDENTIAL

PAGE 20 STATE 076239

TECHNOLOGY.

V. THE SOVIETS IN THE WORLD FOOD EQUATION

CONCERN FOR THE WORLD FOOD PROBLEM HAD ITS ORIGINS IN UNUSUAL DECLINE OF WORLD FOOD PRODUCTION IN 1972. ADVERSE WEATHER CONDITIONS AFFECTED PRODUCTION IN SEVERAL REGIONS SIMULTANEOUSLY. AT THE SAME TIME, NORTH AMERICAN COUNTRIES WERE ENGAGED IN PROGRAMS DESIGNED TO REDUCE THEIR LARGE SURPLUSES, AND THE AVAILABLE PROTEIN SUPPLY WAS BEING FURTHER DIMINISHED BY THE DISAPPEARANCE OF ANCHOVIES FROM PERU'S COASTAL WATERS.

AS THESE SHORTFALLS IN FOOD AVAILABILITY WERE TAKING PLACE, NEARLY ALL THE INDUSTRIALIZED COUNTRIES WERE EXPERIENCING A SUBSTANTIAL ECONOMIC BOOM, WHICH ACCELERATED IN 1973, FURTHER INCREASING THE WORLDWIDE DEMAND FOR FOOD. THE LATE 1973 ENERGY CRISIS AND SUBSEQUENT FERTILIZER SHORTAGES ALSO AGGRAVATED THE

SITUATION.

THE 1972-73 FOOD CRISIS PRACTICALLY EXHAUSTED WORLD GRAIN RESERVES. THE MARGIN OF SAFETY HAS BECOME PERILOUSLY THIN. ANOTHER DISASTROUS PRODUCTION YEAR WOULD CREATE ENORMOUS PROBLEMS. THE LONGER-RUN TRENDS IN WORLD FOOD PRODUCTION AND CONSUMPTION AND PROJECTED INCREASES IN POPULATION SUGGEST THE NEED FOR SUBSTANTIALLY GREATER FOOD PRODUCTION IN BOTH DEVELOPED AND LESS DEVELOPED COUNTRIES.

THE SOLUTION OF THE WORLD FOOD PROBLEM, THEN INVOLVES TWO BASIC ASPECTS:

-- BUILD UP OF A SUITABLE LEVEL OF WORLD FOOD RESERVES AND A MEANS OF DISTRIBUTING FROM THESE RESERVES IN TIMES OF NEED; AND

-- INCREASED FOOD PRODUCTION EFFORTS FACILITATED BY AID TO THE LESS-DEVELOPED COUNTRIES FOR DEVELOPMENT OF AGRICULTURAL PRODUCTION POTENTIAL.

CONFIDENTIAL

CONFIDENTIAL

PAGE 21 STATE 076239

THE WORLD FOOD CONFERENCE HELD IN ROME IN NOVEMBER 1974 WAS THE CATALYST FOR A NUMBER OF NEW APPROACHES TO THE FOOD CRISIS. A MEETING WAS HELD IN LONDON IN

FEBRUARY 1975 TO BEGIN TO ESTABLISH A SYSTEM OF FOOD RESERVES. THE NEW CONSULTATIVE GROUP ON FOOD PRODUCTION AND INVESTMENT WILL BE THE CENTER FOR COORDINATION EFFORTS TO ASSIST AGRICULTURAL DEVELOPMENT IN POOR, FOOD-DEFICIT COUNTRIES.

A. THE SOVIET GRAIN POSITION

PRIOR TO 1970, THE USSR GENERALLY WAS A GRAIN EXPORTER, THE VOLUME VARYING WITH THE SIZE OF THE CROP. NET IMPORTS WERE REQUIRED IN ONLY TWO YEARS, 1963-64 AND 1965-66. SINCE 1970, AND DESPITE EVEN LARGER SOVIET GRAIN CROPS, THE SOVIETS HAVE BECOME IMPORTANT IMPORTERS WITH SUBSTANTIAL IMPACT ON WORLD GRAIN SUPPLIES AND PRICES. THE MAJOR REASON FOR THE SHIFT OF THE SOVIETS TO A REGULAR IMPORTER WAS A CONSCIOUS POLICY CHANGE IN DOMESTIC CONSUMPTION PATTERNS FROM WHEAT AND POTATOES TO LIVESTOCK PRODUCTS.

THE SOVIETS PLANNED TO SUSTAIN THEIR NEW AGRICULTURAL POLICY BY A SUBSTANTIAL EXPANSION IN CROP PRODUCTION WITH OCCASIONAL SUPPORT FROM IMPORTS. BUT PRODUCTION SHORTFALLS HAVE MADE THEM INCREASINGLY

DEPENDENT ON CHEAP GRAIN FROM THE WEST, AS IN THEIR U.S. GRAIN PURCHASE DEAL. SHORTLY AFTER THE DEAL WAS CONSUMATED, HOWEVER, PRICES SOARED, AND IN 1974, THE SOVIETS FOUND THEIR ACCESS TO WESTERN GRAIN MARKETS LIMITED BY INFORMAL MONITORING PROCEDURES WHICH HAD AN EFFECT SIMILAR IN MANY WAYS TO MORE FORMAL EXPORT CONTROLS.

THE ADVERSE IMPACT OF TIGHT FOOD MARKETS, HOWEVER, HAS NOT TURNED THE SOVIETS AWAY FROM THEIR CONSUMER-ORIENTED GRAIN IMPORT POLICY. THEY SEEM WILLING TO ACCEPT THE INSTABILITY IN GRAIN PRICES AND THEIR VULNERABILITY TO ACTIONS BY THE LARGE GRAIN EXPORTERS, PARTICULARLY EXPORT CONTROLS, ADMINISTERED FORMALLY OR INFORMALLY. THEY NOW MUST SEE GREATER LONG-TERM

CONFIDENTIAL

CONFIDENTIAL

PAGE 22 STATE 076239

POTENTIAL FOR GRAIN IMPORTING AS THE WEST MOVES INTO A FOOD SURPLUS SITUATION.

B. THE SOVIET ROLE IN WORLD FOOD ARRANGEMENTS

THE SOVIETS HAVE SHOWN SOME INTEREST IN INSTITUTIONAL ARRANGEMENTS IN THE FOOD AREA. THEY HAVE BEEN MEMBERS OF THE INTERNATIONAL WHEAT AGREEMENT SINCE 1946. THEY ATTENDED THE WORLD FOOD CONFERENCE AND THE INITIAL FOLLOW-UP CONVERSATIONS ON GRAIN RESERVES IN LONDON. THEY WILL BE ONE OF 36 MEMBERS OF THE UNITED NATIONS

ORLD FOOD COUNCIL, AND THERE ARE REPORTS THAT THEY HAVE MADE DISCREET INQUIRIES ABOUT THE CONSULTATIVE GROUP ON FOOD PRODUCTION AND INVESTMENT. IN 1973, THE SOVIETS AND THE UNITED STATES SIGNED AN AGRICULTURAL COOPERATION AGREEMENT; MOSCOW APPEARS TO HAVE BEEN MOTIVATED BY DESIRE FOR TECHNICAL INFORMATION TO HELP EXPAND AGRICULTURAL, AND PARTICULARLY LIVESTOCK, PRODUCTION. THE SOVIET UNION HAS NOT JOINED THE UNITED NATIONS FOOD AND AGRICULTURAL ORGANIZATION. THEIR INVOLVEMENT IN BOTH MULTILATERAL AND BILATERAL FOOD ARRANGEMENTS HAS SUFFERED FROM AN UNWILLINGNESS TO PROVIDE MORE COMPLETE STATISTICAL INFORMATION ON PROJECTED PRODUCTION AND EXPORTS AND VIRTUALLY NONE ON RESERVES. SIMILARLY, THEY HAVE NOT PERMITTED FREE TRAVEL BY US TECHNICIANS TO THE NEW LAND AREAS TO GAIN INSIGHT INTO SOVIET AGRICULTURE. IT IS CLEAR, THEN, THAT THERE ARE TIGHT SELF-IMPOSED LIMITS TO SOVIET PARTICIPATION IN COOPERATIVE EFFORTS ON FOOD.

THE WESTERN INTEREST IN SOVIET GRAIN TRADE IS SUBSTANTIAL. THE PROSPECT OF A LONG-TERM DEMAND FOR

GRAIN COULD HELP WITH THE PERPETUAL WESTERN PROBLEM OF SATISFYING FARMER DEMANDS FOR STABLE AND RENUMERATIVE INCOMES. IF THE SOVIETS CONTINUE THEIR INVOLVEMENT IN WESTERN GRAIN MARKETS, THE AMERICAN AND WESTERN EUROPEAN GOVERNMENTS NEED TO BE ASSURED THEIR PURCHASES WILL NOT BE DISRUPTIVE. THIS WILL REQUIRE CLOSER CONSULTATION AND COORDINATION ON THE SCALE AND TIMING OF SOVIET GRAIN PURCHASES IN WESTERN MARKETS.

CONFIDENTIAL

CONFIDENTIAL

PAGE 23 STATE 076239

THE SOVIET ROLE IN WORLD FOOD CONSUMPTION AND TRADE AND THE IRREGULARITY OF THEIR PURCHASES HAS BEEN A MAJOR FACTOR IN GRAIN PRICE INSTABILITY IN RECENT YEARS. IT IS THUS IMPORTANT THAT THEY BE INVOLVED IN ANY INTERNATIONAL GRAIN RESERVES AGREEMENT THAT IS NEGOTIATED IN LONDON. IT IS ALSO IMPORTANT THAT ANY SYSTEM WORKED OUT HAS EFFECTIVE SAFEGUARDS AGAINST DISRUPTIVE SOVIET BEHAVIOR.

THE USSR DID NOT ATTEND THE LAST MEETING ON RESERVES INDICATING AN AMBIVALENT SOVIET ATTITUDE TOWARD A RESERVES AGREEMENT. THEY ARE SUSPICIOUS OF BECOMING ENMESHED IN A RESERVES AGREEMENT THAT WOULD FOCUS ATTENTION ON THEIR RESPONSIBILITIES TO MINIMIZE GRAIN MARKET DISRUPTIONS. THEY MIGHT ALSO BE WARY THAT A RESERVES AGREEMENT WOULD BE USED AS A LEVER TO GET THEM TO TRANSFER RESOURCES TO LESS DEVELOPED COUNTRIES. IT IS UNLIKELY, HOWEVER, THAT THEY WILL BE ABLE TO RESIST

JOINING A RESERVES AGREEMENT, WITH PREFERENTIAL TREATMENT FOR PARTICIPANTS, ONCE IT IS NEGOTIATED. THEY WOULD NOT WANT TO BE LEFT OUT OF AN AGREEMENT, PARTICULARLY IF IT WOULD PLACE THEM NEAR THE END OF A QUEUE OF IMPORTERS IN A SHORT-SUPPLY SITUATION.

THE SOVIET AMBIVALENCE TOWARD THE LONDON NEGOTIATIONS MAY BE REINFORCED BY A RELUCTANCE TO COMMIT THEMSELVES UNTIL AMERICAN - EUROPEAN COMMUNITY DIFFERENCES ON THE INSTITUTIONAL LOCUS OF THE RESERVES NEGOTIATIONS ARE MORE CLEARLY RESOLVED. IF THE GRAIN NEGOTIATIONS ARE TRANSFERRED TO THE MULTILATERAL TRADE NEGOTIATIONS IN GENEVA BEFORE AGREEMENT IS REACHED, THE SOVIETS MAY WANT TO USE THEIR IMPORTANT ROLE IN FOOD TRADE TO HELP LEGITIMIZE A CLAIM TO PARTICIPATE IN THE TRADE NEGOTIATIONS. ANOTHER OPTION THE SOVIETS MIGHT BE CONSIDERING WOULD BE TO GENERATE LDC SUPPORT FOR MOVING THE RESERVES NEGOTIATIONS INTO UNCTAD, WHERE THEIR INFLUENCE IS GREATER AND IN WHICH THEIR INTERESTS COULD BE BETTER SERVED. ON THE OTHER HAND, IT MAY

BE A LONG TIME BEFORE AGREEMENT IS REACHED, AND THE
CONFIDENTIAL

CONFIDENTIAL

PAGE 24 STATE 076239

SOVIETS WILL NOT BE TIED DOWN TO A POSITION ON RESERVES,
IF THE BASIC NEGOTIATIONS TAKE PLACE UNDER GATT OR
UNCTAD AUSPICES.

VI. THE EASTERN ROLE IN OTHER COMMODITY DEALINGS

THE ENERGY CRISIS AND THE FOOD GRAINS PROBLEM ONLY
REFLECT THE INCREASED IMPORTANCE OF COMMODITY TRADE
IN GENERAL. TROPICAL PRODUCTS AND MINERALS MAY BECOME
THE CENTER OF INCREASINGLY POLITICAL CONFLICTS.

THERE ARE PROBABLY ONLY A FEW RAW MATERIALS OTHER
THAN OIL FOR WHICH THERE IS A SIGNIFICANT PROBABILITY
THAT PRODUCING COUNTRIES COULD PRICE GOUGE OR SIGNIFI-
CANTLY DISRUPT SUPPLIES. THE OIL CRISIS, HOWEVER, CHANGED
PERCEPTIONS IN PRODUCING COUNTRIES, GIVING MANY LDCS THE
HOPE THAT FOR THE FIRST TIME THEY HAD SIGNIFICANT ECONOMIC
BARGAINING LEVERAGE WITH THE DEVELOPED NATIONS.

DESPITE LIMITED CHANCES FOR SUCCESS OF CARTEL-
LIKE ACTIONS, THERE HAVE BEEN A NUMBER OF NEW ATTEMPTS
AMONG COMMODITY PRODUCERS TO ORGANIZE THEMSELVES INTO
PRODUCER-ONLY ASSOCIATIONS DURING THE LAST YEAR AND
A HALF. COMMODITY PROBLEMS WERE AN IMPORTANT ELEMENT
IN THE EUROPEAN-ACP NEGOTIATIONS LEADING TO THE LOME
CONVENTION WHICH INCLUDED A NEW REVENUE STABILIZATION
SCHEME.

THE POLITICIZATION OF COMMODITY ISSUES MAY BE

EXPECTED TO CONTINUE OVER THE NEXT YEAR IN THOSE FORA
WHICH DEAL WITH THESE ISSUES IN A GENERAL WAY. THE
APRIL COMMONWEALTH CONFERENCE IN JAMAICA, THE FORTH-
COMING PRODUCER/CONSUMER ENERGY CONFERENCE, THE UNITED
NATIONS GENERAL ASSEMBLY SPECIAL SESSION IN SEPTEMBER,
AND UNCTAD IV IN 1976 WILL PROVIDE OCCASIONS FOR MANY
PROPOSALS AND DEMANDS, PARTICULARLY FROM THIRD WORLD
PRODUCERS. THE SEPARATE CONFERENCES THIS YEAR DEVOTED
TO RENEGOTIATION OF A NUMBER OF MAJOR COMMODITY AGREE-
MENTS WILL DEAL WITH THE PROBLEMS INVOLVED ON A MORE
SUBSTANTIVE BASIS.

A. THE EASTERN COMMODITY POSITION

CONFIDENTIAL

CONFIDENTIAL

PAGE 25 STATE 076239

THE US DEPENDS ON IMPORTS OF RAW MATERIALS OTHER THAN OIL FOR ABOUT 15 PER CENT OF CONSUMPTION, THOUGH THE TREND IS STEADILY UP FOR THE FUTURE, AND IS A MAJOR EXPORTER OF A RANGE OF MATERIALS. WESTERN EUROPE ON THE OTHER HAND, IMPORTS 75 PER CENT OF ITS RAW MATERIALS. THE SOVIET UNION IS A MAJOR PRODUCER AND WITH A FEW EXCEPTIONS IS VIRTUALLY INDEPENDENT OF OUTSIDE SOURCES. EASTERN EUROPE, ON THE OTHER HAND, DEPENDS HEAVILY ON A WIDE RANGE OF IMPORTED RAW MATERIALS, THE GREAT BULK FROM THE SOVIET UNION. DESPITE THEIR AUTARCHIC TENDENCIES, THE SOVIET UNION IS, BY NECESSITY, SOMEWHAT MORE OUTWARD LOOKING FOR NATURAL RESOURCES THAN THEY ARE FOR MANUFACTURED GOODS:

-- WHILE THE SOVIETS ARE SELF-SUFFICIENT IN MOST RAW MATERIALS, THERE ARE A NUMBER OF ITEMS ON WHICH THEY ARE DEPENDENT FOR IMPORTS, INCLUDING MOST TROPICAL PRODUCTS AND SELECTED RAW MATERIALS SUCH AS RUBBER AND TIN.

-- IN ORDER TO PAY FOR CRUCIAL HARD-CURRENCY IMPORTS THE SOVIETS HAVE EXPORTED MINERALS AND AGRICULTURAL PRODUCTS OF WHICH THEY HAVE HAD A SURPLUS. THE USSR HAS BEEN A REGULAR EXPORTER OF OIL, CHROMIUM, GOLD, TITANIUM, TUNGSTEN, AND UNTIL 1970 OF SUGAR AND GRAINS.

B. THE EASTERN ROLE IN COMMODITY ARRANGEMENTS

THE SOVIETS AND EAST EUROPEANS HAVE GENERALLY BEEN ACTIVE IN INTERNATIONAL INSTITUTIONS DEALING WITH COMMODITY ISSUES. IN ADDITION TO THEIR PARTICIPATION IN THE INTERNATIONAL WHEAT AGREEMENT THE USSR AND THE POLES HAVE ALWAYS PLAYED AN ACTIVE ROLE IN THE INTERNATIONAL SUGAR AGREEMENT. THE USSR IS A MEMBER OF BOTH THE COCOA AND TIN AGREEMENTS, AND HAS PARTICIPATED IN THE

STUDY GROUPS ON RUBBER, TUNGSTEN, LEAD AND ZINC. AS WITH FOOD, A PROBLEM WITH SOVIET PARTICIPATION IN OTHER COMMODITIES IS THEIR RELUCTANCE TO GIVE DATA ON PRODUCTION, CONSUMPTION, AND RESERVES. THEY HAVE, CONFIDENTIAL

CONFIDENTIAL

PAGE 26 STATE 076239

HOWEVER, BEEN MORE FORTHCOMING ON TRADE DATA.

THE SOVIETS AND EAST EUROPEANS ARE LIKELY TO CONTINUE THEIR INTEREST IN PARTICIPATING IN INTERNATIONAL COMMODITY ARRANGEMENTS AND INSTITUTIONS, PARTLY TO PROTECT THEIR LEGITIMATE TRADING INTERESTS IN THOSE COMMODITIES WHICH THEY EXPORT OR IMPORT IN SIGNIFICANT

AMOUNTS. THE EASTERN COUNTRIES ALSO LIKE TO IDENTIFY WITH THIRD WORLD ASPIRATIONS. THE USSR AND OTHER EASTERN EUROPEANS HAVE CONSISTENTLY MADE PUBLIC STATEMENTS IN SUPPORT OF THIRD WORLD EFFORTS TO CONTROL THEIR COMMODITIES, TAKING THE STANCE THAT THEY DID NOT PARTICIPATE IN THE COLONIALIST EXPLOITATION OF NATURAL RESOURCES. THEIR WILLINGNESS TO DISCUSS AND NEGOTIATE COMMODITY AGREEMENTS SUPPORTS THEIR SYMPATHETIC IMAGE TO LESS DEVELOPED COUNTRY PROBLEMS.

THEIR GENERAL PRONOUNCEMENTS NOTWITHSTANDING, THE SOVIET UNION AND EAST EUROPEANS HAVE TENDED TO ALIGN THEMSELVES WITH THE OTHER CONSUMER NATIONS IN SERIOUS INTERNATIONAL NEGOTIATIONS OR DISCUSSIONS ON TROPICAL PRODUCTS AND MINERALS ON WHICH THEY ARE IMPORT-DEPENDENT. THEY DO NOT ENGAGE IN THIRD WORLD TYPE RHETORIC IN THESE DISCUSSIONS, ALTHOUGH THEY SEEM TO BE CONTENT TO LET WESTERN STATES BEAR THE BRUNT OF THIRD WORLD ATTACKS RATHER THAN DEFEND CONSUMER POSITIONS.

GIVEN THE GENERALLY MODERATE STANCE OF THE SOVIETS AND EAST EUROPEANS IN INTERNATIONAL COMMODITY FORA, THE WESTERN COUNTRIES HAVE NOT TENDED TO RESIST COMMUNIST PARTICIPATION IN INTERNATIONAL COMMODITY NEGOTIATIONS. UNLESS THERE IS A SIGNIFICANT CHANGE IN COMMUNIST BEHAVIOR THIS STANCE SHOULD REMAIN VIABLE.

WITH THE NOTABLE EXCEPTION OF CHROME, THE SOVIET AND EAST EUROPEAN ROLE IN COMMODITY MARKETS IS NOT PARTICULARLY THREATENING TO THE NATO POWERS, NOR A SOURCE OF FRICTION IN BILATERAL RELATIONS. AS ONE OF THE THREE MAJOR EXPORTERS OF CHROMIUM (RHODESIA AND SOUTH AFRICA ARE THE OTHER TWO), THEY PLAY A PIVOTAL ROLE IN CHROMIUM MARKETS AND COULD SERIOUSLY DISRUPT THOSE MARKETS IF THEY

CONFIDENTIAL

CONFIDENTIAL

PAGE 27 STATE 076239

CHOSE TO DO SO.

VII. THE BALANCE SHEET

A. THE EASTERN POSITION AND PERCEPTIONS IN THE WORLD ECONOMIC SITUATION

ON BALANCE, THE EASTERN COMMITMENT TO ECONOMIC OPENING TO THE WEST HAS NOT BEEN DISRUPTED BY THE ECONOMIC RECESSION AND THE ENERGY AND FOOD CRISIS. PROSPECTS FOR DEVELOPMENT OF TRADE AND FINANCIAL RELATIONS BETWEEN EASTERN EUROPE AND THE WEST HAVE BEEN DIMINISHED BY RECENT ECONOMIC EVENTS. FOR THE SOVIET UNION, HOWEVER, THE GAINS SEEM ON BALANCE TO OUTWEIGH

ANY COSTS.

-- THE SOVIETS HAVE GAINED COMFORT AND CONFIDENCE FROM THEIR COMPARATIVE ABILITY TO SUSTAIN ECONOMIC GROWTH AND EMPLOYMENT IN A TIME OF MASSIVE WESTERN ECONOMIC TROUBLES;

-- THEY HAVE REASON TO BELIEVE THAT THIS PHENOMENON HAS ENHANCED THEIR OVERALL POSITION AND BARGAINING STRENGTH;

-- THEY PROBABLY THINK THAT THE RELATIVELY MINOR CONSEQUENCES OF WORLD INSTABILITY FOR CONSUMERS IN COMMUNIST COUNTRIES HAVE STRENGTHENED THEIR INTERNAL CONTROL AND GIVEN INCREASED LEGITIMACY TO COMMUNIST IDEOLOGY;

-- THEY HAVE INCREASED THEIR ECONOMIC HOLD OVER THE EAST EUROPEANS;

-- AS MARXISTS THEY MUST WELCOME THE EVIDENCE OF "INTERNAL CONTRADICTIONS" AND "CRISIS IN CAPITALISM" AND PONDER THE OPPORTUNITIES IT MIGHT OFFER.

THERE ARE TROUBLING ELEMENTS THAT TEMPER THIS POSITIVE PICTURE, PRINCIPALLY:

CONFIDENTIAL

CONFIDENTIAL

PAGE 28 STATE 076239

-- PRICE INSTABILITY WHICH COMPLICATES IF NOT DISRUPTS ORDERLY PLANNING AND INTRODUCES INSTABILITY AND UNCERTAINTY IN LONG-TERM PROJECT DEVELOPMENT;

-- SHRINKING PROSPECTS FOR WESTERN PARTICIPATION IN LONG-TERM SOVIET ENERGY DEVELOPMENT WHICH IS AMONG THE HIGHEST PRIORITIES IN THE SOVIET SYSTEM;

-- INCREASED VULNERABILITY TO PRICE RISES AND WESTERN EXPORT MANAGEMENT IN GRAINS WHICH FIGURE IMPORTANTLY IN THEIR CONSUMPTION PROGRAMS.

-- FINALLY, RECENT ACTION BY THE U.S. CONGRESS ON THE EXTENSION OF CREDITS AND MFN TO THE SOVIET UNION HAS CERTAINLY RAISED UNCERTAINTIES FOR THE PROSPECTS AND STABILITY OF SOVIET ACCESS TO THE US ECONOMY.

HOWEVER VIGOROUS SOVIET ATTEMPTS TO APPLY THEIR BARGAINING STRENGTH IN SPECIFIC ECONOMIC TRANSACTIONS, THERE IS NO PRESENT EVIDENCE THAT THEY VIEW THEIR INCREASED STRENGTH AND THE TROUBLES IN THE WEST AS AN

OPPORTUNITY TO DRIVE "CAPITALISM" TO THE WALL. THERE IS LITTLE SIGN THAT THEY SEE ANY DURABLE DAMAGE IN THE CURRENT SITUATION TO LONG-TERM WESTERN ECONOMIC STRENGTH AND POSITIONS. INDEED, WHEN THE DARKEST VIEW IS TAKEN OF ECONOMIC TROUBLE IN THE WEST IT IS TO STRESS THE POTENTIALLY DAMAGING ECONOMIC AND POLITICAL CONSEQUENCES OF A POSSIBLE REPLAY OF THE EVENTS OF THE 1930'S.

B. THE ISSUES OF SOVIET PARTICIPATION IN MULTILATERAL ECONOMIC ARRANGEMENTS

WE HAVE NOTED ABOVE GROWING SOVIET INTEREST IN MULTILATERAL ECONOMIC ARRANGEMENTS. THERE IS NO EVIDENCE THAT THE SOVIETS HAVE MADE A STRATEGIC DECISION TO PURSUE PARTICIPATION ACROSS A BROAD FRONT. SUCH A STEP WOULD REQUIRE A DRASTIC REORDERING OF SOME OF THE BASIC PRINCIPLES OF SOVIET ECONOMIC AND SOCIAL POLICY, INCLUDING THE LONG HELD TENET THAT FOREIGN ECONOMIC POLICY SHOULD BE PURSUED ALMOST EXCLUSIVELY ON A BILATERAL BASIS.

CONFIDENTIAL

CONFIDENTIAL

PAGE 29 STATE 076239

BUT THE QUESTION OBVIOUSLY MAY POSE SOME TEMPTING POSSIBILITIES AS WELL AS DIFFICULT DILEMMAS FOR THE SOVIETS. THE ISSUES IT COULD RAISE FOR THE WEST ARE EQUALLY COMPLICATED. THEY CAN BE GROUPED UNDER FOUR HEADINGS.

1. PARTICIPATION AND SOVIET INTERNATIONAL BEHAVIOR

THE POLITICAL LOGIC THAT UNDERPINS THE ECONOMIC DIMENSION OF DETENTE BEARS ON WIDER SOVIET PARTICIPATION IN WORLD ECONOMIC ARRANGEMENTS. SUCH PARTICIPATION COULD CREATE FURTHER OBLIGATIONS AND STAKES THAT COULD HELP TO MODERATE AND RESTRAIN SOVIET INTERNATIONAL BEHAVIOR. THE WEB OF INTERESTS THAT COULD GROW OUT OF EXPANDED SOVIET PARTICIPATION MIGHT GIVE THEM ADDED INCENTIVES TO ACT CONSTRUCTIVELY INTERNATIONALLY AND RAISE THE COST OF NEGATIVE BEHAVIOR.

THE OBVERSE OF THIS COIN FOR THE SOVIETS IS THE LOSS OF FREEDOM OF ACTION AND EXPOSURE TO LEVERAGE AND INFLUENCE THAT WIDER PARTICIPATION COULD ENTAIL. THIS POSSIBILITY WILL CLEARLY WEIGH HEAVILY IN ANY SOVIET DECISION TO PARTICIPATE IN GIVEN ARRANGEMENTS, THOUGH THEIR STRENGTHENED ECONOMIC POSITION MAY OFFSET THIS SOMEWHAT.

2. PARTICIPATION AND SOVIET INFLUENCE

WHATEVER THE POSSIBLE GAINS IN RESTRAINT AND MODERATION IN THE SOVIET BEHAVIOR, SOVIET PARTICIPATION WOULD ALSO ENTAIL RISKS OF INCREASED INFLUENCE IN INTERNATIONAL ECONOMIC DECISIONS AND ON THE BROADER INTERNATIONAL FRONT. THE SOVIETS MAY IN FACT FEEL THAT MEMBERSHIP IN VARIOUS "CLUBS" WOULD GIVE THEM THE STATUS AND INFLUENCE APPROPRIATE TO A GREAT POWER WITH WORLD-WIDE INTERESTS. MOREOVER, THE MULTILATERAL ARENA COULD FACILITATE SOVIET EFFORTS TO DIVIDE SOME NATIONS FROM OTHERS, AND TO BUILD SPECIAL RELATIONSHIPS WHERE THEY CAN.

CONFIDENTIAL

CONFIDENTIAL

PAGE 30 STATE 076239

WITH THIS SAID IT CAN BE ARGUED THAT THE SOVIETS WILL HAVE ONLY MODERATE WEIGHT AND EVEN LESS LEVERAGE VIS-A-VIS THE MAJOR DECISIONS AND ACTORS IN INTERNATIONAL ECONOMIC ARRANGEMENTS. CERTAINLY THIS IS TRUE IF ONE COMPARESTHEIR RELATIVE WEIGHT AND POSITION TO THOSE OF THE MAJOR WESTERN INDUSTRIAL POWERS AND JAPAN IN ANY DECISIONS AND ARRANGEMENTS CONCERNING MACRO-ECONOMIC COORDINATION, REFORM OF THE MONETARY SYSTEM, OR GUIDELINES CONCERNING INVESTMENT AND THE OPERATIONS OF MULTINATIONAL CORPORATIONS.

THE SOVIETS HAVE MANAGED TO ELUDE THE SHARPEST CRITICISMS FROM LDC'S, PARTIALLY THROUGH LACK OF INVOLVEMENT IN LESS DEVELOPED COUNTRIES AND PARTIALLY THROUGH PAYING LIP SERVICE TO LDC CONCERNS IN THE UN AND OTHER INTERNATIONAL FORA. BUT THE "SYSTEM" WHICH THE THIRD WORLD IS ATTACKING IS ESSENTIALLY THE WESTERN-ORIENTED FREE MARKET WORLD TRADE AND FINANCIAL SYSTEM, AND THE ACTION AND PARTICIPATION THEY ARE SEEKING CONCERNS PRINCIPALLY THE WEST. IRONICALLY THE VERY PROBLEMS THAT LDC DEMANDS CREATE FOR THE WEST UNDERSCORE THE MARGINAL POSITION OF THE SOVIETS. THE SOVIETS HAVE NEITHER MAJOR FOREIGN INVESTMENTS NOR DO THEY HAVE A DETERMINING EFFECT ON THE INTERNATIONAL MARKET FOR PRIMARY PRODUCTS PRODUCED IN THE THIRD WORLD.

3. SOVIET OBJECTIVES AND INCENTIVES

OBVIOUSLY SOVIET SUBSTANTIVE AIMS IN PARTICIPATING IN VARIOUS INTERNATIONAL ECONOMIC ARRANGEMENTS WILL SHAPE THE ROLE THEY PLAY AND THE IMPLICATIONS FOR THE WEST. THIS WILL VARY FROM CASE TO CASE. THUS, IN ENERGY SOVIET AIMS ARE CLOSER TO THE PRODUCERS THAN TO THE CONSUMERS. IN FOOD THE COINCIDENCE OF INTERESTS BETWEEN EAST AND WEST IS CLEARLY GREATER.

WE SHOULD IN ANY CASE EXPECT THE SOVIETS TO SEEK SPECIAL RULES OR STATUS. IN MANY ORGANIZATIONS WHERE THE RIGHT TO DECISION IS RELATED TO ECONOMIC OR FINANCIAL POWER THE SOVIETS COULD FACE A DIFFICULT POLITICAL DECISION OF ACCEPTING SOMETHING SHORT OF FIRST RANK STATUS.
CONFIDENTIAL

CONFIDENTIAL

PAGE 31 STATE 076239

4. THE COSTS OF EXCLUDING THE SOVIETS

IF THE SOVIETS PRESS HARD FOR PARTICIPATION IN WORLD ECONOMIC INSTITUTIONS THE COSTS OF EXCLUDING THEM MAY BE A SIGNIFICANT FACTOR. THE STAKES WOULD INVOLVE BOTH THEIR POTENTIAL BEHAVIOR IN THE SUBSTANTIVE MATTER AT HAND AND THE IMPACT OF EXCLUSION ON THEIR OVERALL INTERNATIONAL BEHAVIOR. IN THE BROADER SENSE A SOVIET UNION WHICH FEELS ITSELF PROGRESSIVELY ISOLATED FROM WORLD ECONOMIC CONCERNS COULD DEVELOP A PATTERN OF BEHAVIOR MORE CONSISTENT WITH CONFRONTATION THAN WITH DETENTE.

-- IN THE FINAL ANALYSIS THE IMPLICATIONS FOR THE WEST OF SOVIET PARTICIPATION IN WORLD ECONOMIC AFFAIRS WILL DEPEND ON PROBABLE SOVIET OBJECTIVES AND BEHAVIOR IN SPECIFIC AREAS AS THEY RELATE TO WESTERN INTERESTS. THUS IT SEEMS NEITHER POSSIBLE NOR DESIRABLE TO DETERMINE A GENERAL POLICY ON THE MATTER. RATHER IT MAY BE BEST APPROACHED ON A CASE BY CASE BASIS, IN LIGHT OF THE ISSUES SKETCHED ABOVE. -

-- DIFFERENCES IN EAST-WEST VALUES AND INTERESTS AND THE ASSYMETRIES OF THE TWO ECONOMIC SYSTEMS WILL BE CONSTANT FACTORS. BUT, WHATEVER THE WESTERN VIEW, IT SEEMS LIKELY THAT THE WEIGHT OF SOVIET INTERESTS WILL OVER TIME CLEARLY IMPEL THEM TO SEEK GREATER PARTICIPATION IN THE WORLD ECONOMY. THUS, THIS WILL BE AN ISSUE WHICH WILL COME INCREASINGLY TO THE FORE AND REQUIRE CONTINUING CONSULTATION AND COOPERATION WITHIN THE WEST. INGERSOLL

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